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## Social and Economic Goals and Their Impact on the Defense Acquisition Process

*Thomas E. Harvey\**

### I. Introduction

Any discussion of the Department of Defense (DOD) acquisition process brings to mind the instances in which DOD purchases have been suggested to have been careless, inept or even profligate. Questions have been raised as to the ability of the DOD procurement system to function as efficiently and effectively as a business in the private sector motivated and judged by profit criteria.

People involved in government procurement operate under strictures not encountered in private enterprise. Their expenditures do more than merely acquire goods and services at the lowest possible cost. A wide variety of social policies is implemented through the government's acquisition process. Although the Commission on Government Procurement cataloged some thirty-eight different social and economic programs furthered through the procurement process,<sup>1</sup> the list is continually changing in response to perceived societal needs and the political pressures of the moment. Current estimates are that there are some thirty-five to forty specific programs in existence and exerting their influence on the acquisition process. These programs are not cataloged in any single place. Some are statutory. Others derive from regulations or from executive directive. Only a familiarity with the government acquisition process makes them apparent.

This commentary considers some of these programs and their impact on the defense acquisition budget and addresses problems created in attempting to utilize the procurement process to further nonprocurement social and economic goals.<sup>2</sup>

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In 1977, after five years with the New York law firm of Milbank, Tweed, Hadley and McCloy, Mr. Harvey was selected by President Carter to be a White House Fellow. The views expressed in this commentary are his own and do not necessarily reflect official policy of the Department of the Army or of the Administration.

1 1 REPORT OF THE COMMISSION ON GOVERNMENT PROCUREMENT 114 (1972).

2 This commentary does not address the impact of various labor-related statutes requiring payment of "the prevailing wage" in various government contracts. These are principally the Davis-Bacon Act, 40 U.S.C. § 276a-1-5 (1976), governing construction contracts; the Walsh-Healy Act, 41 U.S.C. §§ 35-45 (1976), governing supply contracts; the Service Contract Act of 1965, 41 U.S.C. §§ 351-357 (1976), governing service contracts; and the Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (1976), establishing minimum wage and maximum hour standards. Neither does it address the various statutes and regulations relating to Equal Employment Opportunity (EEO) and affirmative action programs oriented toward assuring this. Responsibility for enforcement of EEO provisions was assigned to the Office of Federal Contract Compliance Programs, Department of Labor, on October 5, 1978, by Exec. Order No. 12,086, 43 Fed. Reg. 46,501 (1978). Environmental legislation such as the Clean Air Act of 1970, 42 U.S.C. §§ 1857-1858a (1976), and the Federal Water Pollution Control Act of 1972, 33 U.S.C. §§ 1251-1376 (1976), implemented by Exec. Order No. 11,738, 38 Fed. Reg. 25,161 (1973), which articulates the government's policy "to improve and enhance environmental quality," is also excluded from the discussion. Each of these excluded categories, indeed each of the individual policies discussed here, is on such scope as to warrant a full text devoted exclusively to it.

## II. National Policies Implemented Through the Procurement Process

### A. *Maintenance of a Production Base*

One important factor to be considered in the acquisition of any military material is the need to maintain a domestic production base<sup>3</sup> capable of manufacturing such material in wartime. This often requires the issuance of contracts to acquire limited quantities, often sacrificing economies of scale, merely to enable manufacturers to develop and maintain the skilled work force and capital plant which would be required in a wartime mobilization. The conflict between the desire to acquire goods and services at the lowest possible price and the need to maintain a domestic production base for those goods is particularly vivid in the areas of munitions and armaments manufacture, commodities having minimal nonmilitary markets. In any future war, no time would be available to develop a competent work force and construct the capital facilities necessary to manufacture munitions in the volume required to equip troops in combat.

For certain items, there simply is no commercial production facility which could possibly meet the wartime needs of the military. To supply such materials, it has been necessary for the government to acquire and equip such a facility and then operate the plant itself or contract with private industry for its operation. To assure effective and economical employment of such facilities, the Army Arsenal Act<sup>4</sup> provides that supplies which can be manufactured in such facilities shall be manufactured there.

Having determined to supply its needs through its own facilities, to prevent the erosion of a work force and the economic dislocation which would be created if employment in a region were to be dependent on a single facility responding to the needs of an unstable market, the government has, in some situations, proceeded one step further. This has been done in the area of jewel bearing manufacture. Jewel bearings are integral to various navigational instruments, fire control and communications equipment. The Defense Acquisition Regulation requires that: "Defense requirements for jewel bearings must, to the maximum extent practicable, be procured from the Government-owned

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3 Industrial Preparedness Production Planning, Defense Acquisition Regulation § 1-2200 (1976), established procurement policy for the Department of Defense "in planning with industry for the establishment and retention of industrial base capability essential to national defense for production during periods of national emergencies." (Department of Defense Directive 5000.35, dated March, 1978, changed the name of the Armed Services Procurement Regulation (ASPR) to the Defense Acquisition Regulation (DAR). Although this name change was effective immediately, the regulation itself has not been republished in anticipation of the publication of a uniform Federal Acquisition Regulation (FAR) which will mesh the current DAR governing Department of Defense acquisitions with the Federal Procurement Regulation (FPR) governing procurement by the civilian federal agencies.)

4 10 U.S.C. § 4532 (a) (1976). The Army Arsenal Act provides that "[t]he Secretary . . . shall have supplies needed for the . . . Army made in factories or arsenals owned by the United States, so far as [they] can make those supplies on an economical basis." *Id.* The Air Force Arsenal Act of 1956, 10 U.S.C. § 9532 (1976), provides that the Secretary *may* have supplies needed for the Air Force made at factories, arsenals or depots of the United States. Both provisions conflict directly with the policy of Office of Management of the Budget Circular No. A-76, 44 Fed. Reg. 20,556 (April 5, 1979), "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," which provides at paragraph 4.a: "The government's business is not to be in business . . . ."

William Langer Jewel Bearing Plant, Rolla, North Dakota, which is operated through a contract by the General Services Administration.”<sup>5</sup>

### B. *The Buy American Act and the Balance of Payments Program*

#### 1. The Buy American Act

To assist in the maintenance of a domestic production base, since 1933 the government has followed a policy that manufactured materials acquired for public use shall be substantially constituted from domestically mined or manufactured articles or supplies. Pursuant to the Buy American Act,<sup>6</sup> contracts are to be awarded for domestic goods even though the bid price is as much as six percent in excess of the lowest foreign bid. As a matter of administrative practice, the DOD adds an additional six percent to the differential in cases where the low domestic bid is from a small business concern or a business concern in a labor surplus area. Provisions of the Buy American Act may be waived where it is determined that the purchase is inconsistent with the public interest or the cost is unreasonable after application of the six percent differential.

In addition, since 1962, it has been DOD practice in evaluating bids offering foreign source items against bids-offering domestic source items to apply an alternative fifty percent differential to the foreign prices (without duty).<sup>7</sup> This practice was initiated as one of a number of measures instituted during the 1960's and early 1970's to stem the "gold flow," recognized as a serious problem at that time.

#### 2. The Balance of Payments Program

Although Buy American provisions do not generally apply to goods and services required for use outside the United States, to counteract the unfavorable trade balances existing between the U.S. and those foreign countries in which the U.S. has sizable defense installations, DOD has established a balance of payments program<sup>8</sup> which requires that, where possible, products manufactured in the U.S. will be acquired for use abroad and includes application of the fifty percent differential where items being procured are for use outside the U.S. The purpose of the program is the reduction of overseas dollar expenditures at an *acceptable* increase in budgetary costs.

Additional buy-national restrictions are regularly incorporated in the annual Defense Appropriation Act which restricts the availability of funds for the procurement of foreign source articles of food, clothing, cotton, wool, silk and

5 DAR § 1-2207.2(b) (1976).

6 41 U.S.C. §§ 10a-10d (1976), implemented by Exec. Order No. 10,582, 19 Fed. Reg. 8723 (1954), dated December 21, 1954, which defines domestic goods as being unreasonable in price if the price of such goods exceeds the price of foreign goods (including duty) by more than 6%, *as amended by* Exec. Order No. 11,051, 27 Fed. Reg. 9683 (1962), dated September 27, 1962, and implemented by DAR § VI, Part I. *See also* [1972] 2 GOV'T CONT. REP. (CCH) ¶ 7200.

7 DAR § 6-104.4(b) (1976).

8 DAR § 6-800 (1976). *See also* [1972] 2 GOV'T CONT. REP. (CCH) ¶ 7385.

various specialty metals.<sup>9</sup> Congress has also restricted funds for such things as the acquisition of foreign buses<sup>10</sup> and for research and development contracting with foreign sources.<sup>11</sup>

### *C. NATO Rationalization, Standardization and Interoperability*

In spite of these Buy American considerations, the government is aggressively pursuing a policy to insure that weapons systems within the North Atlantic Treaty Organization (NATO) are interoperable, that is to say, that all NATO nations use basically the same weapons requiring the same types of maintenance and ammunition. The development of competing weapons systems by various NATO allies is not only costly, but also creates awesome logistical problems in any combat situation. Ammunition supplies to provide the requirements of different units each utilizing a different weapon system would be not only expensive, but virtually impossible to maintain in quantities sufficient to meet the needs of units in combat.

The Culver-Nunn Amendment to the Defense Appropriation Act of 1975<sup>12</sup> formally committed the United States to standardization within NATO by requiring annual progress reports for any NATO nonstandard weapon procured by the United States. This gave respectability to the idea that there could be some military procurement outside the United States in the interest of standardization.

The Defense Appropriation Authorization Act for fiscal year 1977 contains an expanded version of the Culver-Nunn Amendment which provides, among other things, that it is U.S. policy to ensure that all NATO equipment is, if not standardized, at least interoperable. To achieve this end, the Secretary of Defense may waive Buy American laws when domestic procurement is determined to be inconsistent with the public interest. New systems intended for NATO use are to conform to a common NATO requirement. Licensing and coproduction agreements between allies are encouraged, and the "two-way street" approach to standardization is endorsed.<sup>13</sup>

Since that time various memoranda of understanding have been executed between the U.S. and certain of its NATO allies, providing for the mutual waiver of buy-national restrictions and access of each to the defense market of the other. Certain of these memoranda also provide for compensating offset agreements. Others provide for coproduction of separable parts of complex weapons systems.<sup>14</sup>

The road toward rationalization, standardization and interoperability of weapons systems within NATO has not been smooth. In addition to considerations of increased military might, economic and political realities have had an

9 DAR § 6-300 (1976). See also [1972] 2 GOV'T CONT. REP. (CCH) ¶ 7270.

10 Act of Sept. 20, 1968, Pub. L. No. 90-500, § 404, 82 Stat. 849 (1969).

11 Department of Defense Appropriation Act of 1973, Pub. L. No. 92-570, § 744, 86 Stat. 1184 (1973).

12 Department of Defense Appropriation Authorization Act of 1976, Pub. L. No. 94-106, § 814, 89 Stat. 531 (1977).

13 Department of Defense Appropriation Authorization Act of 1977, Pub. L. No. 94-361, §§ 802-803, 90 Stat. 923 (1976).

14 A draft of § V of DAR is currently in the final stages of preparation. This section will address implementation of the various Memoranda of Understanding and reprint the full text of each.

impact. National industries gaining business as a result of increased access to an expanded defense market are generally supportive, those losing business as a result of another's more ready access to their market are not. They manifest this displeasure by mobilizing the political forces at their disposal against any such programs.

In early 1978, a special Subcommittee of the House Armed Services Committee was appointed to consider NATO standardization, interoperability and readiness. The subcommittee's report<sup>15</sup> was generally critical of DOD efforts to achieve NATO standardization and interoperability, and concluded that the terms themselves are ambiguous and have produced confusing and conflicting guidance for translating policy into action. Among the report's recommendations was that the Culver-Nunn Amendment be examined in detail to determine whether basic changes should be made to it and the philosophy it embodies.

A real world consideration to be borne in mind as progress, or lack of it, occurs in this area is the more vocal reaction of our NATO allies to what they perceive as an historical imbalance in arms sales within the alliance which has greatly favored the U.S. As this country attempts to encourage its NATO allies to invest more heavily in the defense of the alliance, they are more and more often demanding that they be given their fair share of the economic fallout of a decision to do so. This is further complicated by the fact that our NATO allies have defense industries of widely disparate capabilities ranging from the sophisticated technology and marketing of the Germans, British and French to the much less sophisticated Portuguese, Greeks and Turks.<sup>16</sup>

#### D. *Small Business*

There is a general policy within the government to assist small businesses to obtain and successfully complete procurement contracts. This policy is intended to insure the continued existence of small business concerns, a healthy competitive environment and a broad base of capable suppliers should a national emergency require mobilization of this production base.<sup>17</sup>

The Small Business Administration (SBA) was created in 1953<sup>18</sup> for the purpose of assisting in the creation of a national small business base and insuring that small businesses receive preferential treatment when government procurement contracts are awarded. Every President and each Congress since its inception have consistently reinforced their support for the government's small business program.

In support of small business, the SBA can provide financial assistance to bidders in certain situations, primarily to enable them to complete performance of government contracts. It also guarantees commercial loans to small businesses and makes loans directly to small businesses in disaster or emergency situations. Should a contracting officer question the competency of a small

15 H.R. Rep. No. 1075(II), 95th Cong., 2d Sess. 1 (1978).

16 Gessert, *Industrial Considerations in Transatlantic Weapons Cooperation, Part 1: European Industry and Political Perspectives*, 12 INT'L DEF. REV. 921 (1979).

17 DAR § 1-700 (1976). See also [1972] 1 GOV'T CONT. REP. (CCH) ¶ 1020.

18 Small Business Act of 1953, Pub. L. No. 85-536, § 4(a), 72 Stat. 384 (1959).

business to perform on a government contract, the SBA has the authority to determine conclusively that the small business possesses all elements of responsibility including capability, competency, capacity, credit, integrity, perseverance and tenacity. While in many instances certification of competency has resulted in economies because of issuance of a contract to a small business which was the lowest bidder, the Commission on Government Procurement questioned whether there had been net savings to the government because of increased administrative costs required to assist the contractor and, where he has failed to perform, re-let the contract.<sup>19</sup>

Among the problems faced in the small business program is defining what is a small business. Such a definition differs from industry to industry and from year to year. Although it is recognized that the definition should change to accommodate the intent of congressional programs, changing definitions have confused and handicapped some small firms in obtaining government contracts. With changing definitions, the availability of SBA assistance programs has not always been clear.

Also troubling is the problem of determining what constitutes a fair proportion of the procurement budget to be channeled to small business. The Small Business Act expresses the government policy to insure that small business receives a fair proportion of the total contracts placed by the government.<sup>20</sup>

In 1961 the government established a small business subcontracting program to ensure that small business firms would receive an adequate opportunity to subcontract for divisible portions of larger prime contracts.<sup>21</sup> Yet in times of a constricting federal budget, large contractors become concerned about maintaining their work force and operating their facilities to capacity. As a result, they tend to make rather than buy what would otherwise have been acquired from subcontractors, and when they do buy, first consideration often goes to firms which can offer subcontracts in return.

#### *E. Socially and Economically Disadvantaged Small Business Concerns*

Almost all minority-owned businesses are small; however, most small businesses are not minority owned. Because minority businesses have a series of problems which go beyond those of mere size, in 1978 Congress passed significant amendments to the Small Business Act<sup>22</sup> designed to redress "the historic past discrimination of minorities in their efforts to participate in the free enterprise system."<sup>23</sup>

The amendments direct the creation within each agency of an Office of Small and Disadvantaged Business Utilization responsive directly to the head of the agency or his deputy and responsible for implementing prime and subcontracting programs under the Small Business Act. Included within these pro-

19 1 REPORT OF THE COMMISSION ON GOVERNMENT PROCUREMENT 130 (1972).

20 15 U.S.C. § 631(a) (1976).

21 *Id.* § 637(d).

22 H.R. 11,318 enacted as Act of Oct. 24, 1978, Pub. L. No. 95-507, 92 Stat. 1757.

23 H.R. Conf. Rep. No. 95-1714, 95th Cong., 2d Sess. 22, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 3879, 3883 (accompanying H.R. 11,318).

grams is the requirement that bidders on all large federal contracts submit, before award of contract, a subcontracting plan setting forth percentage goals for the utilization as subcontractors of small business concerns and small business concerns owned or controlled by socially and economically disadvantaged individuals. Failure to comply in good faith with the terms of the plan constitutes a material breach of the contract.<sup>24</sup> The amendments also provide for incentives to prime contractors to encourage subcontracting opportunities to small and disadvantaged firms and a provision that each agency shall establish its own goals for the participation of small and disadvantaged businesses in its procurements.

The original Small Business Act contained a provision at section 8(a) which authorized the SBA to contract with other government agencies and to subcontract actual performance to "small business concerns and others." While the statute contained no mention of minority-owned firms, SBA regulations stated the policy that section 8(a) was to be utilized "to assist small business concerns owned and controlled by socially or economically disadvantaged persons to achieve a competitive position in the market place."<sup>25</sup>

Public Law Number 95-507 gives clear-cut legitimacy to the use of the section 8(a) program for the purpose of assisting minority small business in providing that the SBA may subcontract to socially and economically disadvantaged small business concerns for performance as subcontractors of the various contracts entered into by the SBA pursuant to section 8(a).<sup>26</sup>

#### F. *Labor Surplus Areas*

Defense Manpower Policy Number 4A<sup>27</sup> states that it is the policy of the government to encourage the placing of contracts and facilities in labor surplus areas and to assist such areas in making the best use of their available resources. The Department of Labor classifies geographic areas as labor surplus areas based on the unemployment rate in that labor market. Contracts to be performed in labor surplus areas receive a preference when being evaluated competitively with those to be performed elsewhere.<sup>28</sup>

When President Carter announced his urban area assistance program on March 27, 1978, he stated that, to assure that federal procurement is used to strengthen the economic base of the nation's cities and communities, he would direct expansion of the labor surplus area program and direct DOD to target more of its procurement to high unemployment areas. To date, the Labor Surplus Area program articulated by Defense Manpower Policy Number 4A has been of marginal effectiveness, in large measure, because of the Maybank

24 15 U.S.C. § 637 (1976), as amended by Act of Oct. 24, 1978, Pub. L. No. 95-507, § 211, 92 Stat. 1757.

25 13 C.F.R. § 124.8-1(b) (1978). This limitation of § 8(a) authority was upheld as a reasonable means of promoting the statutory goal in *Ray Baillie Trash Hauling, Inc. v. Kleppe*, 477 F.2d 696 (1973), cert. denied, 415 U.S. 914 (1974).

26 The SBA rules for implementing the changes effected by Pub. L. No. 95-507 were published on May 29, 1979, at 44 Fed. Reg. 30,672 (1979).

27 Preservation of the Mobilization Base Through the Placement of Procurement and Facilities in Labor Surplus Areas, 32A C.F.R. ch. 1, pt. 134 (DMP-4A) (1979), issued by the Office of Emergency Planning pursuant to the authority of the Defense Production Act of 1950, 50 U.S.C. §§ 2061-2166 (1976); Exec. Order No. 10,480, 18 Fed. Reg. 4939 (1953); and Exec. Order No. 11,051, 27 Fed. Reg. 9683 (1962).

28 Department of Defense policy with regard to Labor Surplus Areas is set forth in DAR § 1-800 (1976).



Amendment to the Department of Defense Appropriations Act of 1954<sup>29</sup> which has been carried over in the Defense Appropriations Act. The current language reads: "[N]o funds herein appropriated shall be used for the payment of a price differential on contracts hereafter made for the purpose of relieving economic dislocation."<sup>30</sup>

Notwithstanding DOD's strong support for the Maybank Amendment, efforts have been made by various members of Congress over the years to eliminate it. To date, none have been successful.

### *G. Anti-Inflation*

The President's anti-inflation program announced October 24, 1978,<sup>31</sup> directed, among other things, that the federal procurement process be conducted so as to recognize anti-inflationary efforts and to channel business to those firms which limit wage and price increases. By the President's order, the Council on Wage and Price Stability was directed to enforce his wage-price guidelines by denying contracts of five million dollars or more to companies violating the standards. On November 8, 1978, the Federal Register contained proposed amendments to the Defense Acquisition Regulation which would implement this presidential directive.<sup>32</sup>

By these regulations and those promulgated by the Office of Federal Procurement Policy, prospective contractors are required to "voluntarily" certify compliance with the wage and price standards.

On May 31, 1979, Judge Barrington D. Parker of the U.S. District Court for the District of Columbia ruled that the President had exceeded his constitutional authority in issuing Executive Order Number 12,092.<sup>33</sup>

On June 22, 1979, in a six-to-three decision, the U.S. Court of Appeals for the District of Columbia overturned the lower court ruling.<sup>34</sup> Writing for the majority, Chief Judge J. Skelly Wright agreed with the Government's argument that the President's authority to impose economic sanctions to achieve compliance with the wage and price guidelines is conferred by the Federal Property and Administrative Services Act of 1949<sup>35</sup> requiring the President to promote economy and efficiency in procurement. Section 205(a) of the Act provides that the President "may prescribe such policies and directives, not inconsistent with the provisions of this Act, as he shall deem necessary to effectuate the provisions of said Act."<sup>36</sup> While section 3(b) of the Council on Wage and Price Stability Act<sup>37</sup> prohibits the President from imposing "any mandatory economic controls," the court found that this did not apply to the voluntary guidelines of the Executive Order.

29 Pub. L. No. 179, 67 Stat. 336 (1953).

30 Department of Defense Appropriation Act of 1978, Pub. L. No. 95-457, § 824, 92 Stat. 1243 (1978).

31 Exec. Order No. 12,092, 3 C.F.R. § 249 (1979).

32 43 Fed. Reg. 52,032 (1978).

33 AFL-CIO v. Kahn, 472 F. Supp. 88 (D.D.C. 1979).

34 AFL-CIO v. Kahn, No. 79-1564 (D.C. Cir. Sept. 14, 1979).

35 40 U.S.C. §§ 471-544 (1976).

36 *Id.* § 486(a).

37 Pub. L. No. 93-387, § 3(b), 88 Stat. 750 (1974).

### III. Problems

The range of nonprocurement economic and social goals furthered by the government acquisition process is extensive. An awareness of the potential for government contracting as a means for promoting social and economic objectives developed during the Depression of the 1930's. The use of this tool has expanded greatly since that time.

The principal problem engendered by the use of the procurement process in the implementation of national economic and social goals is that the procurement of material becomes more costly and time-consuming with the addition of each new social and economic program. Legitimate questions may be raised as to how much of the extra costs and other burdens of these social and economic programs should be absorbed in the procurement process and how much should be supported by more explicit means. Indeed, is the use of the procurement process even an efficient vehicle to deliver the benefits sought through the implementation of the social and economic policies? While the cost of pursuing nonprocurement objectives through the procurement process cannot be precisely measured, it is significant.

In addition to costs, the patterns of social and economic objectives implemented through the procurement process disclose various conflicts in priorities. The need to maintain a domestic production base is in direct conflict with the need to achieve rationalization, standardization and interoperability of weapons systems and other equipment within NATO. Buy American and balance of payments considerations may lead to purchases of goods and services at other than the lowest possible price. Debarment of a low bidder because of noncompliance with anti-inflationary guidelines necessitates procurement from the next highest responsible and responsive bidder. Requiring a small business to invest its limited resources in the costly exercise of preparing a bid proposal conflicts with the stated objectives of developing and maintaining economically sound small business firms. Throughout this process an intangible cost is incurred in that citizens, unaware of the social policies being furthered through the procurement process, lose respect for the process and for the government as a whole as they observe the government purchasing items at higher than the lowest possible cost for the purpose of furthering these social goals.

Recognizing many of these problems, in 1969 Congress created the Commission on Government Procurement to promote the economy, efficiency and effectiveness of procurement by the Executive Branch. The Commission studied the procurement system for two years, and, on December 31, 1972, presented the results of its study to the Congress. The Commission's four-volume report contained 149 recommendations for improving government procurement.

The first recommendation of the Commission was that an Office of Federal Procurement Policy (OFPP) be established in the Office of Management and Budget for the purpose of rationalizing the government's procurement policies. OFPP is now in the final stages of revising and consolidating the Federal Procurement Regulation and the Defense Acquisition Regulation into

the Federal Acquisition Regulation. Although it is likely that this effort will bring some rationalization to the procurement process, the temptation to continue to use the vast federal procurement budget to further worthwhile social goals will continue to win out over any efforts to create a rigid procurement structure.